

an existing Form FmHA or its successor agency under Public Law 103–354 426–1 will be dated and initialed. The reason for any deletion will be noted on the Form.

[41 FR 34571, Aug. 16, 1976, as amended at 61 FR 59777, Nov. 22, 1996]

§ 1806.2 Companies and policies.

Property insurance policies or other evidence of insurance will be accepted from borrowers when the requirements outlined herein are complied with fully.

(a) *Companies.* It is desirable that companies be licensed to do business in the particular State or other jurisdiction where the property is located, or that they be otherwise authorized by law to transact business within such State or other jurisdiction (hereinafter called “State”). If the required insurance is not available locally at comparable rates from an insurance company licensed or otherwise authorized to do business in the State, insurance may be accepted from another company if (1) the OGC advises that policies issued by such company will not be rendered unenforceable by virtue of the company’s failure to be licensed or otherwise authorized to transact business in the State and that the company is a legal entity which may be sued in the State where the insured property is located, and (2) the State Director determines that the company is reputable and financially sound. In making the above determinations, the State Director will consider all relevant available information such as that which may be obtained from financial statements, Best’s Insurance Reports, State insurance authorities, and other lending institutions.

(b) *Insurance policies*—(1) *Standard policies.* If a standard fire insurance policy has been adopted for the State, it should be used unless State statutes exempt the company from the regulations requiring its use. The standard policy is one containing substantially the same standard provisions adopted or recommended by legislative action or by order of the supervisory insurance authorities of the State in which the security is located.

(2) *Other policies.* To be acceptable, any other insurance policies must con-

form to the requirements of this Instruction.

(i) “Homeowner’s” policies, “All Physical Loss” policies, “Broad Form” policies, and other such all-inclusive policies are acceptable if they otherwise meet the requirements of this Instruction.

(ii) A builder’s risk policy naming the borrower as the insured or a builder’s risk endorsement for a policy issued to the borrower may be accepted during the period a building is under construction if the policy otherwise meets the requirements of this Instruction. If such a policy or endorsement does not automatically convert to full coverage when the building is completed, acceptable insurance must be obtained simultaneously with the expiration of the builder’s risk provisions of the policy.

(iii) A builder’s risk insurance policy issued to a contractor only may not be substituted for the property insurance, the borrower is required to provide.

(iv) Borrowers eligible for insurance under the National Flood Insurance Act of 1968, as amended by the Flood Disaster Act of 1973, will be serviced in accordance with subpart B of this part.

(3) *State instructions.* If the State Director and the OGC consider it advisable, a State Instruction may be issued to help County Supervisors identify standard insurance policies adopted for the State. The Instruction should also furnish a guide to assist in identifying other acceptable insurance policy forms that are commonly used by insurance companies in the State, recognizing that such information is not all inclusive.

(4) *Binders.* Whenever there is a justifiable reason for not issuing a policy or endorsement, as required, a written binder will be acceptable for a period not to exceed 60 days from the effective date of the insurance. The written binder must have attached thereto the approved form of mortgage clause. Such a binder will be submitted to the County Supervisor in lieu of an insurance policy or endorsement and the insurance policy or endorsement will be submitted on or before the expiration date of the binder. The State Director, with the advice of the OGC and subject

to prior approval of the National Office, may issue a State Instruction authorizing such binders to be accepted for periods longer than 60 days.

(5) *Submission of Policies.* (i) For Farmer Program (FP) loans secured by a first lien, the original policy or declaration page must be delivered to the County Supervisor. The original policy or declaration page will be returned to the borrower after one year using Form FmHA or its successor agency under Public Law 103-354 426-4, "Notice of Expiration of Insurance."

(ii) For Single Family Housing (SFH) loans secured by a first lien, the original policy or declaration page must be delivered to the closing agent.

(iii) In cases where an FP or SFH loan is secured by other than a first lien and the mortgage clauses include the names of the prior mortgagees, a certificate of insurance, copy of the policy, or other evidence of insurance is acceptable.

(iv) The County Supervisor will process an advance to pay for insurance only in strict compliance with provisions of §1806.6 of this subpart.

(6) *Master sets.* If the master sets meet all of the requirements of this Instruction they may be accepted in lieu of an original policy for each FmHA or its successor agency under Public Law 103-354 borrower.

(i) One complete master set of the different insurance forms for policies issued by the insurance company must be on file in each County Office where the company insures property of FmHA or its successor agency under Public Law 103-354 borrowers.

(ii) The "Declaration Page" furnished by the insurance company for each borrower insured, in lieu of a complete policy, will be filed in the borrower's case folder. When a "Declaration Page" in the form of a computer printout is used by an insurance company an endorsement on every policy issued by that company or a letter from that company will be obtained and attached to the printout. However, a letter signed by an authorized official of the company and addressed to the State Director may cover all policies issued by that company in the State. Any such endorsements or letters should clearly state that the company

considers the printout to be an original "Declaration Page". Such endorsements or letters are not necessary if the printout itself clearly states that it is an original "Declaration Page."

(7) *Name and location.* The policy should contain names of all the borrowers who are owners of the property being insured, and it will be returned for correction if it does not do so. The location of the property should be so described in the policy that the property can easily be identified. The complete legal description of the property by metes and bounds is not required. Any deviation from the requirements of this paragraph must first be cleared with the National Office.

(8) *Loss or damage covered.* Buildings must be insured against loss or damage by fire, lightning, windstorm, hail, explosion, riot, civil commotion, aircraft, vehicles, and smoke.

(9) *Effective date of insurance.* If there are insurable buildings located on the property, the borrower will arrange with his agent or company to have adequate insurance in force at the time the loan, assumption, or credit sale is closed so that the policy will properly insure the borrower and the mortgagees. When new buildings are erected or major improvements are made to existing buildings, such insurance will be made effective as of the date materials are delivered to the property. The County Supervisor will make no payments from loan funds for labor or materials until the borrower has furnished adequate insurance to protect the interest of the FmHA or its successor agency under Public Law 103-354 in the buildings being erected or improved.

(10) *Term.* The borrower will be required to furnish insurance for a term of at least one year with evidence that a full year's premium is paid. The term "premium" as used herein includes any assessments which may be charged to the borrower. If the assessments are of the type imposed only after a loss occurs involving property insured by the insurance company, then the borrower must present evidence (such as a letter from the company) that he currently does not owe any such assessments. The borrower may receive a discount for insuring for a longer period such as three years or five years and with an

annual premium. If the insurance contains an automatic renewal clause, its provision should be substantially the following to be acceptable to FmHA or its successor agency under Public Law 103-354:

This policy will be automatically extended for successive terms at expiration of the original term and of each extension thereof, upon payment of renewal premiums. It is a condition of this policy that if the policy expires or is canceled for nonpayment of premium, or for any other reason, the mortgagee will be given 10 days notice.

(11) *Mortgage clause.* The standard mortgage clause adopted by the State must be attached to or printed in the policy, or Form FmHA or its successor agency under Public Law 103-354 426-2, "Property Insurance Mortgage Clause (Without Contribution)," must be attached to or the provisions thereof printed in the policy. A letter signed by an authorized official of an insurance company to the State Director, stating that all insurance policies the company issues in the State and in which the FmHA or its successor agency under Public Law 103-354 has a mortgage interest incorporates all of the provisions of Form FmHA or its successor agency under Public Law 103-354 426-2 may be accepted in lieu of attaching Form FmHA or its successor agency under Public Law 103-354 426-2 to each policy. If such a blanket letter is used, the FmHA or its successor agency under Public Law 103-354 will be named in the loss payable clause and a State Instruction will be issued, after prior approval is obtained from the National Office, authorizing the use of such method.

(i) If the use of a mortgage clause, other than the standard mortgage clause (without contribution), has been made mandatory by State laws or insurance regulations, a State Instruction will be issued, after prior approval is obtained from the National Office, authorizing the use of such a form.

(ii) When an approved mortgage clause is printed in the policy a "Loss Payable Clause" is acceptable provided the FmHA or its successor agency under Public Law 103-354, as mortgagee, would receive payment in case of loss even though the company would not be liable to the borrower. A "Loss

Payable Clause" which contains the statement that the mortgagee is "subject to all terms and conditions of the policy" is not acceptable.

(iii) Whenever a new mortgage clause including the interest of the FmHA or its successor agency under Public Law 103-354 is issued after the policy has been in force, the new mortgage clause must be signed by an authorized agent or officer of the company that issued the policy. Form FmHA or its successor agency under Public Law 103-354 426-6, "Transmittal of Property Insurance Mortgage Clause," may be used to transmit the mortgage clause to the insurance official.

(iv) The FmHA or its successor agency under Public Law 103-354 and all other mortgagees whose interests are insured by the policy will be shown either in the mortgage clause or in the "Declaration Page" in the order of priority of their mortgages.

(A) "United States of America (Farmers Home Administration or its successor agency under Public Law 103-354)" will be named in the mortgage clause for direct and insured loan mortgages naming FmHA or its successor agency under Public Law 103-354 as mortgagee, whether in its own right or as trustee under a 2(f) or other agreement with a State Rural Rehabilitation Corporation.

(B) "United States of America (Farmers Home Administration or its successor agency under Public Law 103-354), as first mortgagee or as statutory agent and insurer of such mortgagee," will be named in the mortgage clause for insured FO mortgages naming the lender as mortgagee, whether the mortgage is held by the original or a subsequent lender or by the insurance fund or by FmHA or its successor agency under Public Law 103-354 under a trust agreement or declaration of trust.

(C) If the designation is not identical to that set forth in paragraphs (b)(11)(iv)(A) or (B) of this section, whichever is applicable, it will be sufficient if the mortgagee is readily identifiable as the Farmers Home Administration or its successor agency under Public Law 103-354.

(c) *Evidence of premium payment.* (1) When Form FmHA or its successor

agency under Public Law 103-354 426-2 is attached to or the provisions thereof are printed in the policy, or a blanket letter from an insurance company incorporating the provisions of Form FmHA or its successor agency under Public Law 103-354 426-2 in all policies in which the FmHA or its successor agency under Public Law 103-354 has a mortgagee interest in effect, in accordance with paragraph (b)(11) of this section, no evidence of premium or assessment payment is required except for the first year of the loan. When a subsequent FP or section 502 RH loan is made to build, buy or rehabilitate essential buildings an endorsement to the existing policy including coverage for the property improved will be sufficient.

(2) [Reserved]

(d) *Policy restrictions.* (1) Any insurance on essential buildings as defined in §1806.3 having restrictions which limit the amount of collectable insurance must meet the FmHA or its successor agency under Public Law 103-354 requirements set forth below (except for the clause described in paragraph (d)(1)(iv) of this section which is never acceptable); otherwise, such restrictions must be eliminated or modified to afford the required protection.

(i) *Coinurance clause.* This clause generally provides that in consideration of a reduced rate, the borrower agrees to maintain insurance on his buildings up to a specified percentage (usually 80 percent) of their value and that the company will not be liable for a greater proportion of any partial loss than the amount of insurance bears to the specified percentage of either the undepreciated replacement value or the depreciated replacement value (actual cash value) of the buildings at the time of the loss. When the buildings are insured for the specified percentage of their value, the company, in the event of a partial loss, will be liable for the full amount of the loss not to exceed the amount of insurance. A coinurance clause can be accepted only where the amount of insurance is at least equal to the specified percentage of either the undepreciated replacement value or the depreciated replacement value (actual cash value). For ex-

ample, an 80 percent coinsurance clause can be accepted only where the amount of insurance on each insured building is at least equal to 80 percent of the appropriate replacement value of the insured building.

(ii) *Three-fourths' value clause.* This clause provides that the liability of the company shall be limited to three-fourths of the depreciated replacement value of the buildings covered at the time of the loss, not to exceed the amount of insurance. This clause may be accepted if the unpaid balance of the loan is not greater than three-fourths of the depreciated replacement value of the building and the amount of insurance is at least equal to the unpaid balance of the loan and any prior liens and no building is insured for more than three-fourths of its depreciated replacement value.

(iii) *Loss deductible clause.* (A) For all loans other than RRH, RCH, and LH organizations this clause generally provides that loss to each building to the extent of the limitation is not recoverable. The company is liable only for loss to each building in excess of such limitation stated in the clause. This clause may be accepted where the limitation does not exceed \$150, or one percent of the insurance coverage whichever is greater. In no case, however, may the limitation on any one building exceed \$500.00.

(B) For RRH, RCH, and LH organization loans this clause generally provides that loss to each project to the extent of the limitation is not recoverable. The company is liable only for loss to each project in excess of such limitation stated in the clause. This clause may be accepted where the limitation does not exceed the option shown below that is chosen by the borrower and agreed to by the Loan Approving Official and properly annotated in the borrower file. The borrower and FmHA or its successor agency under Public Law 103-354 Official should consider the economic impact to the project when selecting the appropriate option.

(1) Option 1—Up to one-fourth of one percent (0.0025) of the insurable value. Maximum deductible \$5,000.

(2) Option 2—Up to a maximum deductible of \$500 on any project with an insurable value not exceeding \$200,000.

(3) Option 3—Option 1 may be chosen and increased above the maximum deductible by an amount equivalent to funds specifically escrowed in the project replacement reserve account as an offset to the increased deductible.

(4) Option 4—Option 2 may be chosen and increased above the maximum deductible by an amount equivalent to funds specifically escrowed in the project replacement reserve account as an offset to the increased deductible.

(5) The funds used to increase the deductible in Option 3 or Option 4 may be from project funds if it does not create an unsecure financial situation for the project. Also, non-project funds may be used for Option 3 or 4 and then repaid by withdrawal from the project at the rate of 75 percent of the annual insurance premium savings earned by the amount of escrow deposit, up to the amount deposited.

(6) The funds escrowed to increase the authorized deductible will be placed in the project reserve account as an increased amount in and above the amount required by the Loan Agreement/Resolution and so annotated in the borrower's accounting system.

(iv) *Three-fourths' loss clause.* This clause provides that the company will not pay more than three-fourths of any loss, nor more than three-fourths of the amount of insurance in force. This clause is never acceptable and must be eliminated.

(v) *Deferred loss payable clause.* This clause provides that, if the amount payable under the policy for any loss to any building insured shall be in excess of a specified portion, (usually 60 percent) of the amount of insurance on such building, the company will withhold from its initial loss payment any sum in excess of the specified portion of the amount of insurance on such building. If the building sustaining such loss is repaired or replaced within six months from the date of the fire and at or within 300 feet of the original location, as described in the policy, the company upon receipt of evidence to that effect from the insured will pay the full balance withheld from the initial payment, provided the amount ex-

ceeded in repairing or replacing the building damaged or destroyed will equal or exceed the amount of loss as determined under the terms of the policy. Failure to repair or replace any insured building within the time and manner provided will constitute acceptance of the initial payment as full and final settlement under the policy with respect to the loss. This clause may be accepted if the amount of insurance is for the full depreciated replacement value (actual cash value) of the building and the unpaid balance of the loan and any prior lien(s) is not greater than the initial loss payment made by the company.

(vi) *Construction specifications and use conditions.* If the insurance policy contains clauses which specify certain standards of construction or prescribes certain uses of the property for the insurance to be valid, the policy is acceptable only if the property meets such specifications or conditions at the time of acceptance. For example, if the policy provides that the chimney be constructed of a certain type of material, the County Supervisor should be assured that the required material has been used, or if the policy provides that farming operations are not carried out on the premises he should be assured that this condition is met.

(2) Policies generally will not be accepted if, under the terms of the policies or local laws, contributions or assessments may be made against the FmHA or its successor agency under Public Law 103-354. However, policies which impose assessments on the borrower may be accepted only if the FmHA or its successor agency under Public Law 103-354 mortgage will be recorded prior to any failure of the borrower to pay any such assessments. Policies also will not be accepted if, by their terms or other conditions, loss payments are contingent upon collective action by the Board of Directors, or the stockholders, or the members.

(e) *Buildings on leaseholds.* The policy will indicate that the insured is the lessee or tenant and not the owner of the buildings securing the FmHA or its successor agency under Public Law 103-354 loan; or, if he is the owner of the building on the leased land, the policy will indicate that the insured is the

owner of the building, but not of the land. State Directors, with the advice of the OGC will issue State Instructions to meet any other special requirements needed to conform with the insurance requirements of the State to enable leaseholders to obtain property insurance for buildings which are security for FmHA or its successor agency under Public Law 103-354 loans.

(7 U.S.C. 1989; 42 U.S.C. 1480; 40 U.S.C. 442; 42 U.S.C. 1480; 42 U.S.C. 2942; 5 U.S.C. 301; Sec. 10 Pub. L. 93-357, 88 Stat. 392; delegation of authority by the Secretary of Agriculture, 7 CFR 2.23; delegation of authority by the Assistant Secretary for Rural Development, 7 CFR 2.70; delegations of authority by Director, OEO, 29 FR 14764, 33 FR 9850)

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§ 1806.3 Coverage requirements.

The County Supervisor should encourage the borrower for his own protection to insure for their depreciated replacement value (actual cash value) all essential buildings. Essential buildings include the dwelling and any other buildings that are necessary for the operation of the property or that provide income to assure orderly repayment of the loan. If insurance is for less than the depreciated replacement value of all essential buildings, the County Supervisor will see that the coverage is obtained on one or more of the most essential buildings. The minimum amount of coverage will be furnished as prescribed below:

(a) *Loans secured by a first lien.* (1) When the unpaid balance of the FmHA or its successor agency under Public Law 103-354 loan secured by a first lien is equal to or greater than the depreciated replacement value of the essential buildings, or the cost of adequate essential buildings which can be constructed for amounts less than the depreciated replacement value of the existing buildings, the essential buildings will be insured, to the nearest multiple of insurance that is available, for the lesser of (i) their depreciated replacement value, or (ii) the cost of constructing adequate essential buildings. For example, if insurance is available in only multiples of \$1,000, the min-

imum insurance required on an essential building valued at \$6,600 would be \$7,000, and that required on an essential building valued at \$6,400 would be \$6,000.

(2) When the unpaid balance of the loan is less than the sum of the depreciated replacement value of the essential buildings to be insured, the total amount of insurance must be at least equal to the lesser of (i) the unpaid balance of the loan, or (ii) the cost of adequate essential buildings which can be constructed for amounts less than the depreciated replacement value of the existing buildings to be insured.

(3) When, by the use of loan funds or otherwise, buildings are erected or substantial improvements are made to essential buildings, the amount of insurance will be adjusted in accordance with paragraphs (a)(1) or (2) of this section, whichever is applicable.

(b) *Loans secured by other than first liens.* The amount of insurance on buildings in the case of FmHA or its successor agency under Public Law 103-354 loans secured by other than a first lien will be the same as required in paragraph (a) of this section, with the understanding that the unpaid balance of the loan will be deemed for this purpose to be the amount of the total real estate mortgage indebtedness owed all prior mortgagees named in the mortgage clause, plus the debt to the FmHA or its successor agency under Public Law 103-354 which is secured by real estate mortgage.

(c) *Exception of buildings from insurance.* (1) Insurance will not be required on a building:

- (i) That is not essential.
- (ii) In such a state of disrepair that the cost of insurance would be prohibitive.
- (iii) Which has a depreciated replacement value of \$2,500 or less.
- (iv) Which is being or has been repaired with a section 504 loan of \$7,500 or less. Families receiving section 504 loans should be encouraged but not required to carry insurance on their home.

(v) On LH security property which was not built or repaired with FmHA or its successor agency under Public Law 103-354 loan funds provided that the State Director determines that the